

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

DOCKET NO. 2000-210-W/S - ORDER NO. 2002-751

OCTOBER 23, 2002

IN RE: Application of United Utility Companies, Inc. for Approval of an Increase in its Rates for Water and Sewer Services Provided to all of its Service Areas in South Carolina.))))	ORDER DENYING PETITIONS FOR RECONSIDERATION OR REHEARING
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This matter comes before the Public Service Commission of South Carolina ("Commission") on separate Petitions for Reconsideration or Rehearing ("Petitions") filed by United Utility Companies, Inc. ("UUC"), the Applicant in the above-referenced proceeding, and by the Consumer Advocate for the State of South Carolina ("Consumer Advocate"), an Intervenor in the above-referenced proceeding. For the reasons set forth below, the Commission denies both Petitions for Reconsideration.

PETITION FOR RECONSIDERATION OR REHEARING OF UUC

By its Petition, UUC alleges that its substantial rights have been prejudiced because the Commission's findings, inferences, conclusions, and decisions made in Order No. 2002-214 are clearly erroneous, unsupported by substantial evidence, arbitrary and capricious, characterized by abuse of discretion, in violation of constitutional or statutory provisions, made upon unlawful procedure, or affect by other errors of law on the following points:

1) the effect of the rate of return of 0.15% established for UUC in Order No. 2002-214 denies UUC the rate relief to which it is entitled under the law and the evidence of record in the instant case;

2) the phase-in of the rate relief awarded by Order No. 2002-214 is not supported by the factual basis upon which the Commission determined that (a) a phase-in of rates was needed in addition to the reduction in UUC's authorized return on equity in order to protect customers, (b) that a three-year period was needed to so protect customers, and (c) why a three-year period was the appropriate frame in which to phase-in the rates; and

3) Order No. 2002-214 adopts the following accounting adjustments which are unsupported by the evidence of record:

(a) the Commission disallowed the salary expense for one plant operator position that was vacated during the test year but which position was filled subsequent to the end of the test year; and

(b) the Commission disallowed \$35,225 of the rate case expenses incurred by UUC as of the date of the hearing and for which UUC provided documentation of such expenses.

1. Insufficient Rate of Return

UUC argues that the Commission's decision in Order No. 2002-214, wherein the Commission adopted a return on equity for UUC of 0.15%, denies UUC the rate relief to which it is entitled under the law and the evidence of record in this case. UUC Petition, p. 2, ¶ 4.

In Order No. 2002-214, the Commission found it appropriate to set rates using the rate of return on rate base methodology. Order No. 2002-214, p. 5, ¶ 3; 9-10. The determination of return on rate base requires the following three components: (1) capital structure, (2) cost of equity (also referred to as return on equity), and (3) the cost of debt. Order No. 2002-214, p. 5, ¶ 4.

UUC alleges error by the Commission in failing to set a return on equity that fell within the ranges testified to by either UUC witness Ahern or Staff witness Spearman and in failing to set forth sufficient facts relied upon by the Commission in reaching its decision. Further, UUC asserts that the Commission's conclusion that a higher rate of return would result in rate shock to the customers is error in that the Commission's conclusion is unsupported by the evidence of record and by law. Finally, UUC argues that the Commission improperly concluded that it could deny UUC's proposed rate requests because UUC had not sought rate relief in eleven years prior to the filing of the instant application.

In Order No. 2002-214, the Commission found that its "approved return on common equity [to be] appropriate in light of the potential rate shock that a higher return would impose on the customers of UUC." Order No. 2002-214, p.13. Further, the Commission specifically noted that UUC had waited over eleven years to seek rate relief and admonished UUC to be more vigilant to avoid seeking such dramatic increases which burden the consumers. Order No. 2002-214, pp. 13-14.

The Commission is aware that it must exercise a certain amount of discretion in the rate-making arena. Rate-making is not an exact science, but a legislative function

involving many questions of judgment and discretion. *Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984). In a rate case utilizing rate of return on rate base methodology, the rate of return on rate base would determine the income requirement for the utility. Thus the Commission, in an exercise of its discretion and judgment, set a cost of equity which would produce rates which the Commission determined would be fair and reasonable for both UUC and the ratepayers. The Commission finds no error with its decision in Order No. 2002-214 as the Commission is mindful that it must balance the interests of the utility with those of the ratepayers. The Commission believes that it has accomplished that balance in its decision in Order No. 2002-214.

2. “Phase-in” of Rates

UUC alleges error by the Commission in “phasing in” the rate relief granted by Order No. 2002-114. In Order No. 2002-114, the Commission found “it appropriate to phase-in the rates in equal installments over a three year period in order to avoid ‘rate shock’ to the customers of UUC.” Order No. 2002-114, p. 6, ¶ 15. UUC takes exception with the Commission’s determination of need for a phase-in of rates and alleges that Order No. 2002-114 fails to set forth the factual basis upon which the Commission determined (a) that a phase-in was needed to protect the customers, (b) that a three year phase-in period was needed to so protect the customers, and (c) that a three year period was the appropriate time period for the phase-in. Petition of UUC, p. 7, ¶ 5. UUC further asserts that no provision of South Carolina law permits a phase-in of rates to be charged

by a utility and that the Commission acted beyond the authority granted to the Commission. *Id.* at 7-8, ¶ 5.

First, the Commission finds that UUC is wrong in asserting that the Commission is without authority to order a phase-in of rates. UUC appears to interpret S.C. Code Ann. Section 58-5-240(C) as allowing the Commission to approve the full rates requested or a part of the rates requested. S.C. Code Ann. Section 58-5-240(C) provides that “[t]he Commission shall rule and issue its order approving or disapproving the charges in full or in part within six months after the date the schedule is filed.” While this code section provides the Commission with the time frame in which to issue its order, it does not, as UUC alleges, prevent the Commission from instituting a phase-in of rates. A phase-in of rates is merely a vehicle by which rates are implemented in parts. Thus even under UUC’s theory, the Commission’s ordered phase-in is an approval (or disapproval) in part of the requested rates.

At the night hearing on this matter, customers of UUC described the impact and hardship they would feel if the full rate increase were levied upon them. Testimony indicated that the aftermaths of September 11, 2001, were being felt by these customers and that the downturn in the economy was impacting these customers. Interestingly, some customers indicated they recognized the need of UUC for some rate relief. Taking these testimonials with the other evidence presented, the Commission was left to determine the appropriate rates for UUC. As noted above, the Commission found it proper to utilize rate of return on rate base methodology in setting rates for UUC. Rate-making is not an exact science, but a legislative function involving many questions of judgment and discretion.

Parker v. South Carolina Public Service Commission, 280 S.C. 310, 313 S.E.2d 290 (1984).

Recognizing and utilizing its discretionary authority, the Commission determined that the rates, and resulting revenues, requested by UUC were not reasonable. The Commission noted that the requested rates produced an average increase in rates of 78.77%. Order No. 2002-214, p. 51. Nonetheless, the Commission approved a rate increase amounting to 50.89% of the requested increase. *Id.* In order to avoid rate shock to the customers, the Commission, in an exercise of its discretionary powers and in order to soften the effect of the increase to the customers, phased-in the approved rates over three years. *Id.* Upon consideration of UUC's assertions in its Petition, the Commission discerns no error. The Commission is mindful that it must balance the interests of the utility with those of the ratepayers. The Commission believes that it has accomplished that balance in the remedy it fashioned in Order No. 2002-214.

3. Accounting Adjustments

UUC asserts error alleging that two accounting adjustments adopted by the Commission in Order No. 2002-214 are unsupported by the evidence of record. UUC challenges the Commission's (a) disallowance of salary expense for one plant operator position and (b) disallowance of \$35,225 in rate case expenses incurred by UUC as of the date of the hearing.

(a) With regard to the disallowance of salary expense associated with one plant operator position, UUC asserts that this expense should have been allowed as a known and measurable change because UUC provided a pay receipt to Staff demonstrating that a

replacement employee had been hired subsequent to the end of the test year and that the Staff witness accepted the pay receipt as evidence that inclusion of the replacement operator was appropriate.

In Order No. 2002-214, the Commission adopted the Staff position, as contained in the Staff Report (Hearing Exhibit No. 9), with respect to the expense adjustment for Operators' Salaries. The Staff adjustment consisted of two parts: (1) to capitalize operators' salaries for the test year and (2) to remove one operator's position from the adjustment proposed by UUC. UUC takes exception with the Commission's adoption of the second part of the Staff adjustment relating to the removal of one operator's position. The Commission, in adopting the position to remove the salary for the operator position from UUC's proposed adjustments, concluded that the operator position was not filled at the time of the Staff's audit and would therefore not be included in test year expenses.

Upon consideration of UUC's exception, the Commission finds no error in its decision. Rate-making is not an exact science, but a legislative function involving many questions of judgment and discretion. *Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984). The "test year" formula serves as a mechanism to isolate the data which necessarily must be reviewed in order to determine the rate base, and, consequently, the validity of a requested rate increase. *Id.* Essential to the success of this method of rate base determination is the establishment of a "cut-off" date, to insure some degree of finality in the rate-making process. *Id.* In Order No. 2002-214, the Commission found that the operator's position was not filled at the time of the Staff's audit and would therefore not be included in test year expenses. Order No. 2002-

214 at 18. The Commission had before it the exhibits prepared by Staff witness Dowdy which indicated that the operator position was not filled as of the date of the Staff audit of UUC's books and records. The Commission exercised its judgment and discretion in deciding that the cut-off date for adjustments should be the date of the Staff audit. There exists evidence of record for the Commission's decision as demonstrated by witness Dowdy's exhibits, thus the Commission's exercise of discretion is not without evidentiary support. See, Hearing Exhibit No. 9. Accordingly, the Commission finds no merit in UUC's assertion of error.

(b) As to rate case expenses, the Commission approved rate case expenses in the amount of \$4,314 representing rate case expenses incurred and billed as of the date of the Staff's audit. The Commission amortized the rate case expenses over a three year period thus allowing \$1,438 to be included in the setting of the rates for UUC. UUC alleges error by the Commission in not allowing \$35,225 in rate case expenses as of the date of the hearing on this matter.

As noted above in the discussion regarding the salary expense for one salary operator, rate-making is not an exact science, but a legislative function involving many questions of judgment and discretion. *Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984). The "test year" formula serves as a mechanism to isolate the data which necessarily must be reviewed in order to determine the rate base, and, consequently, the validity of a requested rate increase. *Id.* Essential to the success of this method of rate base determination is the establishment of a "cut-off" date, to insure some degree of finality in the rate-making process. *Id.*

In determining rates for a utility, the Commission cannot and does not guarantee that every penny of expense will be recovered by the utility. In this case, the Commission weighed the amount of the requested rate increase and the needs of UUC against the impact of that increase to the customers. The evidence of record, as noted by numerous witnesses at the night hearing, clearly shows that the customers are of moderate means who are faced with certain economic downturns following the aftermath of September 11, 2001, and a declining economy. The Commission in reaching its decision exercised its discretion with regard to this expense item and decided on an adjustment with which UUC does not agree. The Commission finds no error in its decision on this adjustment.

Having addressed the Petition of UUC, the Commission must now address the Petition filed by the Consumer Advocate.

PETITION FOR RECONSIDERATION OF CONSUMER ADVOCATE

By its Petition, the Consumer Advocate alleges error by the Commission in its decision set forth in Order No. 2002-214 and asserts that the Commission's actions in Order No. 2002-214 constitute arbitrary and capricious actions and are in violation of the Due Process and Equal Protection Clauses of the Constitutions of the United States and South Carolina by the Commission in the following particulars:

- 1) in rejecting the Consumer Advocate's proposal regarding rate case expenses by finding that the Consumer Advocate's proposal would result in retroactive rate-making;
- 2) in rejecting the Consumer Advocate's proposal regarding adjustments for expense variances; and

3) in rejecting the Consumer Advocate's proposed adjustments to Operators' Salaries and Officers' Salaries expenses.

1. Rate Case Expenses

In Order No. 2002-214, the Commission rejected the proposal of the Consumer Advocate regarding rate case expenses and found that the Consumer Advocate's proposal violated the rule against retroactive rate-making. Order 2002-214, pp. 23-27. In this case, the Consumer Advocate recommended no recovery of rate case expense in rates going forward due to "over-payment" of rate case expenses subsequent to the last rate proceeding for UUC in 1990. *Id.* at 23. The Consumer Advocate pointed to the last rate case of UUC and noted that the Commission had allowed \$7,133 of rate case expenses to be used in setting rates. *Id.* Further, those rate case expenses were amortized over a three year period. *Id.* The Consumer Advocate contends in the instant proceeding that because the rate case expenses from the last rate case in 1990 were included in rates after the three year amortization period that the amount included in rates after the three years should offset rate case expenses in the instant case. The Commission did not accept the proposal of the Consumer Advocate and found that the proposal of the Consumer Advocate violated the rule against retroactive rate-making. *Id.* at 24-26.

In asserting error by the Commission, the Consumer Advocate argues that if the amortization period set for recovery of an expense is imprecise, then that expense should be adjusted in the next rate proceeding. Petition of Consumer Advocate, p. 2. The Consumer Advocate further alleges that his position was "what was done for the [utility] in the case of *Porter v. South Carolina Public Service Commission and Carolina Water*

Service, 328 S.C. 222, 493 S.E.2d 92 (1997), and that is what must be done here,” or any other treatment would be inconsistent with the Supreme Court’s ruling. Petition of Consumer Advocate, p. 2. In arguing that his position does not constitute retroactive rate-making, the Consumer Advocate, relying on *Porter*, states that “just as the unamortized rate case expense in that case was an extraordinary expense, the excess revenues collected by UUC represent extraordinary revenues which must be used to adjust [UUC’s] expenses in this case. *Id.*

In Order No. 2002-214, the Commission found the Consumer Advocate’s proposal amounts to impermissible retroactive rate-making and is therefore prohibited by law. Contrary to the Consumer Advocate’s assertion in its Petition, Order No. 2002-214 does not suggest that “the Consumer Advocate has ... proposed changing any past rates for the purpose of reparations or refunds.” Petition of Consumer Advocate, p. 2, ¶ 4. To the contrary, Order No. 2002-214 specifically recognizes that the Consumer Advocate proposes to offset the present rate case expenses for what the Consumer Advocate perceives to have been an over-recovery of expenses built into UUC’s rates approved in Order No. 90-651. Order No. 2002-214, pp. 23-26. As found in Order No. 2002-214, the Consumer Advocate’s proposal is retroactive rate-making, and retroactive rate-making is proscribed by South Carolina Law. *Porter v. South Carolina Public Service Commission and Carolina Water Service*, 328 S.C. 222, 493 S.E.2d 92 (1997). See, also, *Popowsky v. Pennsylvania Public Utility Commission*, 164 Pa.Cmwlth. 338, 344, 642 A.2d 648, 651 (1994), which held that “[t]he rule against retroactive rate-making prohibits a public utility commission from setting future rates to allow a utility to recoup past losses or to

refund to customers excess utility profits.” *Popowsky* was cited by the Court in *Porter* with approval, and its holding describes exactly that which the Consumer Advocate seeks in its Petition – the setting of rates for UUC based upon purported excess revenues earned in the past.

The Consumer Advocate’s proposal is not “to simply treat consumers in a manner consistent with the treatment afforded [UUC] in its last rate case.” Petition of Consumer Advocate, p. 2, ¶ 4. In UUC’s last rate case, UUC was allowed to recover rate case expenses amortized over a three year period, resulting in an expense amount included in rates of \$7,133.00. Order No. 2002-214 at 23. Under the Consumer Advocate’s proposal, no rate case expense would be allowed in the instant case. The Consumer Advocate’s proposal is totally inconsistent with the treatment afforded UUC in the last rate case as UUC’s customers would be treated in a manner consistent with UUC’s last rate case only if rate case expenses, amortized over a three year period, are allowed.

The Consumer Advocate’s contention that *Porter* mandates the disallowance of rate case expense in the instant case is also without merit. UUC has not collected any “excess revenues” as alleged by the Consumer Advocate (Petition of Consumer Advocate, p. 2, ¶ 4) because the revenues collected under the lawful rates approved for UUC are, by law and necessity, revenues arising from just and reasonable rates. The Consumer Advocate provides no authority to support his contention that “the excess revenues collected by UUC represent extraordinary revenues which must be used to adjust [UUC’s] expenses in this case.” Petition of Consumer Advocate, p. 2, ¶ 4. Further, there can be no “excess revenues” absent a finding of over-earning on the part of UUC,

and there is certainly no indication of UUC exceeding the return approved for UUC in its 1990 rate case. Without a finding that revenues exceeded the authorized return for UUC, any mechanism which would reduce future rates in order to adjust for past revenues collected pursuant to lawfully established rates would be retroactive rate-making. Clearly, the Consumer Advocate's proposal of offsetting rate case expenses would result in reducing the future rates to adjust for past revenues and is therefore proscribed by law.

The Commission finds no error in its decision in Order No. 2002-214 to reject the Consumer Advocate's proposal with regard to offsetting rate case expenses as such proposal would require the Commission to engage in retroactive rate-making which is proscribed by law. Therefore, the Consumer Advocate's Petition is denied as to this alleged error.

2. Expense Variances

The Consumer Advocate asserts error by the Commission in rejecting the proposal of the Consumer Advocate's witness, Mr. Bleiweis, regarding "Expense Variances." In Order No. 2002-214, the Commission "conclude[d] that the proposed adjustments do not indicate an unusual situation which would require adjusting the test year data. Order No. 2002-214, p. 36. Further, the Commission found that "the data and testimony presented by the witness for the Consumer Advocate indicates that the proposed adjustments have not normalized the test year but have in fact skewed the test year by only proposing adjustments for one side of the equation without applying the same type of adjustments for the other side of the equation." *Id.*

In surrebuttal testimony and responding to criticisms of UUC witness Lubertoizzi, Mr. Bleiweis acknowledged that his proposal was not the only means by which the Commission could determine whether test year data should be employed for rate-making purposes when he stated that he was “merely suggesting to the Commission that it consider another strategy for determining whether test year data should be accepted for rate-making purposes ...” Bleiweis Surrebuttal at 2, ll. 1-3 (emphasis added.). In fact, Mr. Bleiweis’ testimony recognizes that employment of the Commission’s standard test year methodology was acceptable. Thus, the testimony of the Consumer Advocate’s own witness provides evidence in support of the Commission’s decision.

In asserting error, the Consumer Advocate complains that the Commission’s decision violates the Supreme Court decision of *Hamm v. South Carolina Public Service Commission and South Carolina Electric and Gas Company*, 309 S.C. 282, 422 S.E.2d 110 (1992). Contrary to the Consumer Advocate’s alleged error, *Hamm* does not require adoption of Mr. Bleiweis’ suggested alternative method of determining allowable expenses. The Consumer Advocate overlooks the precedential underpinning of *Hamm*, which is *Parker v. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984). *Parker* makes clear that routine occurrences in the operation of a utility leading to fluctuations in utility accounts, such as increased revenue expected to result from the addition of customers, do not render test year figures atypical. 313 S.E.2d at 292. Staff witness Dowdy verified on cross-examination that fluctuations in individual expense accounts are indicative of routine occurrences and are neither unusual nor

unexpected. Accordingly, we find that *Hamm* does not compel the result sought by the Consumer Advocate.

Contrary to the Consumer Advocate's assertion otherwise, an evidentiary basis does exist for finding that Mr. Bleiweis' "recommendations do not indicate an unusual situation that requires adjusting test year data." Petition of Consumer Advocate, p. 3. The testimony of Staff witness Dowdy and UUC's witness Lubertozi provide the basis for the Commission's finding. These witnesses' testimonies established that variations in normal utility expense categories do not demonstrate that test year expenses are atypical, particularly when other specific expense categories are demonstrated to have decreased over the same time period are not accounted for and total expenses over a five year period are consistent with test year expenses. As noted in Order No. 2002-214, the Staff compares the test year Operation and Maintenance Expense of a utility with the Operation and Maintenance expenses reported in the annual reports for the prior five years. Order No. 2002-214, p.35. Because rate-making is not an exact science but involves the exercise of discretion and judgment, the Commission was free to not only accept the recommendation of Staff witness Dowdy as to treatment of expense variation but was also free to reject Mr. Bleiweis' recommendation. Thus, the Commission finds no error in accepting the Staff's methodology regarding expense variances.

3. Operators' Salaries and Officers' Salaries Expenses

The Consumer Advocate argues error by the Commission with regard to the adjustments for Operators' Salaries and Office Salaries expenses. With regard to these expense items, the Commission adopted the Staff's position which capitalized operators'

salaries for the test year and removed one operator's position from operators' salaries expense and which annualized office salaries and removed the annualized salary of one retired employee from office salaries expense. Order No. 2002-214, pp. 16 - 20. The Consumer Advocate asserts the Commission erred in not adopting his witness' position with regard to this item which questioned why UUC allocated a larger share of service company salaries for the test year than in previous years. Petition of Consumer Advocate, pp. 4-5, ¶ 6.

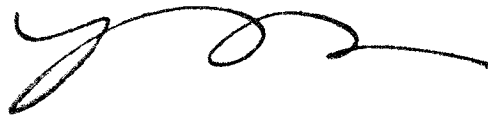
The Commission finds no error with its determination in Order No. 2002-214. In Order No. 2002-214, the Commission acknowledges that the Consumer Advocate contended that UUC had failed to meet its burden of establishing the reasonableness of its pro forma operator and office salaries adjustments. Order No. 2002-214, pp. 17-18. The Consumer Advocate's argument regarding justification of the allocation of Illinois office workers' salaries to Water Service Corporation clearly pertained to the office salaries and proposed to reject UUC's adjustment in this account. Bleiweis Direct Testimony, p. 33, l. 1- p.34, l. 7. Accordingly, Mr. Bleiweis, the witness for the Consumer Advocate, recommended an adjustment of (\$2,067). *Id.* In adopting the adjustment of the Staff, the Commission, in effect, adopted the adjustment proposed by the Consumer Advocate, but just not on the ground suggested by the Consumer Advocate. Thus, there is no error in the Commission's decision because the result it reached is the same as offered by the Consumer Advocate. Further, there is sufficient evidence to support the Commission's conclusion that UUC met its burden of proof as to the office salaries allowed given that

Staff's audit supported the figures approved by the Commission. Accordingly, the Commission finds no error with its decision on this issue in Order No. 2002-214.

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED THAT:

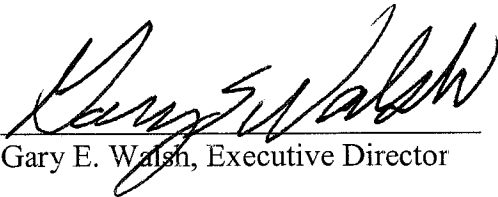
1. For the reasons herein stated above the Petitions for Reconsideration or Rehearing filed by UUC and by the Consumer Advocate are denied.
2. This Order shall remain in full force and effect until further Order of this Commission.

BY ORDER OF THE COMMISSION:



Mignon L. Clyburn, Chairman

ATTEST:



Gary E. Walsh, Executive Director

(SEAL)